THE COFFEES OF
THE SECRETARY-GENERAL
PETER GEORGESCU

3 May 2016
The Coffees of the Secretary

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Bringing New Perspectives to the OECD

Secretary-General’s Speech Writing and Intelligence Outreach Unit
Peter Georgescu is the author of “The Constant Choice – An Everyday Journey From Evil Toward Good”.

He is Chairman Emeritus of Young & Rubicam Inc., a network of preeminent commercial communications companies dedicated to helping clients build their businesses through the power of brands. He served as the company’s Chairman and CEO from 1994 until January 2000.

Under Mr. Georgescu’s leadership, Young & Rubicam successfully transformed from a private to a publicly-held company. During his tenure, Young & Rubicam built the most extensive database on global branding and, from its findings, developed a proprietary model for diagnosing and managing brands. Within the marketing community, he is known as a leading proponent of creating unified communications programmes, agency accountability for measuring the impact of communications programmes, and structuring value-based agency compensation. In recognition of his contributions to the marketing and advertising industry, Mr. Georgescu was elected to the Advertising Hall of Fame in 2001.

Mr. Georgescu immigrated to the United States from Romania in 1954. He was educated at Exeter Academy, received his B.A. with cum laude honors from Princeton and an MBA from the Stanford Business School.

Mr. Georgescu’s belief in the power of education has fuelled his involvement with organisations such as A Better Chance and Polytechnic University, both of which he has served as a member of their Boards of Directors. The University of Alabama and Cornell College in Iowa have awarded Mr. Georgescu honorary doctorate degrees. Mr. Georgescu is also the recipient of the Ellis Island Medal of Honor. In 2014, he was honoured with the Spirit of the City award by the Cathedral of Saint John the Divine.

Mr. Georgescu continues to serve as a board member of a publicly registered company, Geeknet. Previously, he has served on the Boards of Levis Strauss, Toys R Us, EMI Recorded Music, International Flavors & Fragrances and Briggs & Stratton. He is currently Vice Chairman of New York Presbyterian Hospital, a Trustee of the Paul & Daisy Soros New American Fellowship Program and is a member of the Council on Foreign Relations.


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"Capitalists Arise: Defining the Problems and Consequences of Inequality"

Thank you very much, I am delighted to be here and I would particularly like to thank Ambassador Yohannes who reached out to me several months ago and who is responsible for starting this very meaningful and important relationship that I have with the OECD. I also want to thank Lamia Kamal Chaoui for her help in organising and steering today’s event.

I’m here in Paris to talk about inequality, or as you call it: the need for inclusive growth. We know that this is an extraordinary challenge for all members of the OECD and far beyond. We can also tell that inequality of income, which leads to inequality of opportunity, is a real and serious threat, it is a threat to our way of life, our civil society, it is unjust, immoral and indeed unsustainable. I take my hat off to the OECD for being at the forefront of this crisis, you have rang the bell, you have the research and amazing data to diagnose the problem and to reach out with new initiatives.

I want to focus my presentation on the business sector, for two purposes. Firstly, I want to share with you what I believe is the culpability of business in this area; and secondly, to also point to important areas where potential and dramatic solutions in helping this crisis can be found. I also think that, as the title says, we capitalists must arise because we have the capacity and should have the wisdom and the urgency to bring solutions to this socio-economic crisis. We need to agree that a change in our behaviour, a real change in the way we do business is going to

1 The original transcript of the presentation by Peter Georgescu has undergone minor editing to ensure that the text published in this brochure is presented in a reader-friendly format.
become essential and therefore we must act with urgency. The good news is that if we do act wisely the probability is very high that the solutions will bode well for the future of growth and prosperity.

My presentation will focus exclusively on the United States for the reasons that I know something about the United States and because it is a market where the problem is perhaps the most severe – surprisingly – in the world today. Understanding the US will inform other markets and other members of the OECD and beyond. So indeed I think it is time for us capitalists to arise. We must arise for a very important purpose – to preserve free enterprise capitalism. I say that because free enterprise capitalism today is at risk and the consequences of potentially losing our growth engine, to me is about as catastrophic as you can get to our way of life and to our success.

We know that the free capitalist market engine can work and has worked amazingly well. For example, if you look at the period right after the Second World War up until late 1970s, this engine created America’s leading economic and military power and the most powerful middle class economically. A middle-class market which in fact provided fuel for America’s economic success. And miraculously, the principles of free enterprise capitalism have helped lift hundreds of millions of people out of abject poverty. If you think about India, China, Brazil and parts of Africa amazing things have happened to produce more humane standards of living around the world.

But, enter the crisis of income and wealth inequality and what we are seeing is that this free enterprise capitalist system of today does not seem to be working. It is not addressing the problem. There are many countervailing economic, political and social forces marshalling around which threaten the viability of free market capitalism. That is obviously a very great concern on two levels: firstly, the engine used to work; and secondly, the engine is not working any more. With my presentation I want to firstly define with certainty, or raise the question ‘is income and wealth inequality really as serious a problem as we are making it to be?’ Because in order for us to really force change we must be sure that we are solving a worthy problem. The second point is to understand the reasons why free market capitalism today is not working. What is different about it? If we understand that, perhaps we can re-imagine the third part. To re-imagine what free market capitalism can and should do in order to provide solutions to this crisis.
Before I get into the presentation, I want to make a couple of contextual comments. In discussions with other business leaders we hear: ‘what’s wrong with inequality?, inequality is ok, we are all unequal, we are born unequal, our life journeys are unequal, so why are we getting so exasperated about this problem?’. We need to ask the question, ‘when does inequality become a serious issue?’ I suggest that it becomes a serious issue when not just a few people, but a large minority of people are affected. Where the economic power of a nation is concentrated in that group and the disparity becomes too large, that’s when something bad happens. Each nation has a contract, an implicit or explicit contract with its citizens about how a standard of living applies to all of its citizens. In America that started with the Jeffersonian idea of the pursuit of happiness and of property which stated ‘that is a right for all the citizens of America’. And if you translate that into modern lingo, equality of opportunity is to be the very best that you can be given your resources and intelligence in your industry. When that contract gets broken, when that opportunity no longer exists – then we have problems.

The second objection that I get is, if there’s an economic problem the market will fix it, the market fixes everything. It’s this unwise hand that governs the universe and fixes problems. So I went looking for the market and I couldn’t find it, I looked in the ether and could not find it there. I am trying to say that the market is something else, the market is an explicit, and sometimes implicit, agreement about how business is conducted. What are the rules of the game that are acceptable at any one point in time? We know that free market is never totally free, there are legal constraints, the banks place rules when they lend money, government has all kinds of regulations and there is a moral, ethical, secular understanding of how we behave.

So the free market notion becomes important in order to understand the difference between what the free market called acceptable in the past and what the free market calls acceptable today.
Figure 1 shows household data, and in particular, what happens to a household at the end of the month and at the end of the year — because then we can understand whether there is a serious problem. If there is nothing left at the end of the month when you have paid all your bills, then you have a problem. After all expenses have been taken out we look at what is left at the end of the day. Some level of discretionary expenses to be spent for a better standard of living, or for investment purposes, or for savings. This graph shows us that about 55% of Americans are broke at the end of each month. They have to borrow money to put food on the table, and this debt is beginning to accumulate because you can’t pay it out. And that is the flipside of wealth, being poor is very expensive. If you look at the sixth decile, you see it breaks even, $41 at the end of the month — so we basically do not have a middle-class in America. While the upper middle-class averages about $8,500 of savings per year. In the past, the middle class used to have a child or two in private schools, two cars, maybe a cabin in the countryside. Would that be possible with $8,500 per year? Not if you have a serious problem with your car, or God forbid an illness, or a roof leak. Nobel prize winning economist Joseph Stieglitz stated that 4 out of 5 Americans in their lifetimes will experience some form of poverty and this data proves this. The upper 20% are doing fine and life is good for them.

Duke University conducted a survey (Figure 2) and asked people ‘in your opinion what would be the ideal distribution of wealth in America?’ They said that the top 20% should possess about 30% of total wealth. They were then asked what they thought today’s reality was? They answered that the top 20% in fact own a lot more than that, almost 60% of total wealth. But the reality is even more severe, the top 20% own almost 90% of wealth in America. And that is a problem because as I said, the flipside of that is debt. In addition, large concentration of wealth reduces investment, because rich people do not spend money, they do not consume.

What are the consequences of this socio-economic problem of inequality? Let me start with education which is a disaster. In America public education is paid by real-estate taxes, so poor small households gain no education. The wife of my co-writer is a second grade teacher in Rochester, New York. At the beginning of every school year she goes to classrooms with bags full of paper-pads, pencils and pens because neither the school, nor the parents have money to pay for the fundamentals of learning. This is what is happening in many areas, that’s what inequality is. It is not the north, south, east or west. It is right next door. People can hear the music of the wonderful country club across the railroad tracks. Terrible education means high-school drop-out rates of 60-70%; and those few who get to college drop-out very quickly because they are not academically prepared to stay there, or socially for that matter, they cannot compete with the rest of the 20%.
I am vice-Chairman of a large hospital and neurology is an area of interest to me. I want to talk about something called cortisol which fascinates me. Cortisol is a hormone which is produced in the brain and basically what it does is it tames down the cognitive skill set, the executive capability of where we are right now, and in stressful situations it produces the fight or flight syndrome. So the kids go to school angry, underfed and they are supposed to learn – it cannot be done. Most of these areas also do not offer early education – but there is plenty of education for the upper 20%. And if you do not put your kids through some form of early education by the age of three, they just cannot compete by the time they get to first grade.

In single parent homes, a mother usually has two jobs, there is never a dinner time to sit down and talk with the kids at home. Where will they get the academic support, for school and for peer problems, dealing with life, ethics and morality? Instead there is drug and alcohol abuse and high crime. An African American writer who grew up in New Orleans and Chicago writes about the black on black crime and he has told me of the amount of time and energy spent trying to figure out the route he has to take to go to his grandmother’s house and make sure that he is not going to get in trouble. Unemployment and structural unemployment are high, probably over 15% in America today; and there is a dramatic drop in life expectancy among white males. If you take the top 1% life expectancy and the bottom 1% the difference today is 15 years of life.

The current version of free enterprise is therefore not helping all Americans – we have established income inequality and a vanishing middle class. This socio-economic situation is creating an India style caste system and it is one that it is very tough to get out of unless you run very fast, or jump very high, or you are a great athlete, or a genius that somebody recognises.
And that is the ultimate problem, the creation of grossly unequal opportunities for most citizens in America. This is what breaks the contract within the nation.

There is nothing systemic in our business environment today that does anything but drive inequality further and further apart every day. Nothing exists that can bridge this gap today as business is being conducted. The writings of Ariel and Will Durant in the 1960s said ‘the world has seen this problem before and it can be solved in one or two ways: you either redistribute wealth through punitive taxation, as Piketty said; but wealth redistribution never works, it is not sustainable. But you can also redistribute poverty. This happened in France in the 1800s, it happened with the Bolsheviks – and I know something about that, I was in a work camp for 5 years – it happened in Cuba, in Venezuela, in the Middle East during the Arab Spring. We have seen bubbling in Paris and many cities in America and at some point in time there will be a kindling point where worse things are going to happen. This is a rejection of free enterprise growth as a system of fixing our economic problems. Finding a solution for business is therefore critical, and business needs to lead the way.

Let me point out that Walmart had the highest market cap in America until about 6 months ago when Amazon took over – Walmart employs 2.1 million people while Amazon employs 150,000. So you understand the problem. Many political decisions always favour the wealthy, the managerial classes, the owners versus the employees. Unions have lost bargaining power, they have failed in America to fight the relevant battles. They always fought the wrong battles, they always thought that management was the enemy, they never said ‘let’s get together and create a bigger pie to share’, so they have been losing out in the private sector.

Because we cannot do much about technology and globalisation other than to say that both of them can be friends not just enemies if we put our minds to it. Nobody is asking technology to
say ‘hey how can we help create more jobs for more people?’ we ask technology to do a lot of things, but not that.

Who can fix the problem? Governments can definitely contribute a lot. Not so much in America because for the last 8 years we have had this crisis of two parties fighting each other and nothing comes out of Congress. In America, at least, business is the only institution that has a chance to begin to create solutions. The ultimate solutions would be for government and private industry to collaborate together, and that is how we hope to end up.

But let me go back and look at what free market capitalism was and why it worked in the past. It worked because the modern American corporation was built on 5 critical stakeholders. First was the customer, because without the customer nothing ever happens; Secondly it is the employees – because companies were created by society to help society produce what it needed a little bit more efficiently, more simply and more productively; Third was the shareholders who in those days produced the major difference, which was money; Fourth is the corporation itself which needs to be fed to sustain itself over time and to stay relevant over time; And Fifth the communities in which corporations do business. Corporation used to get huge tax advantages to be good citizens in the community, to take care of and be a positive force in that community.

At its best free enterprise capitalism was not only fair and responsible, but it optimised – not maximised – all five stakeholders. That is what was magical about that thirty year period and it worked like a Stradivarius violin. As late as the 1980s, the Chamber of Commerce’s definition of business was to create jobs and to pay people fairly. In 1946, Johnson & Johnson wrote their credo, and it is an example of what it took for business to get it right. It begins by stating “we believe our first responsibility is to the doctors, nurses and patients, the mothers, the fathers”, in other words, the customer. They knew they had to produce good quality products, at a good price and care for their customers. The second responsibility is to the company’s employees “the men and women who work throughout the world for us, we must consider them, care for them, feed
them and make sure their families are well taken care for and their vacations are paid for, etc.” And it continues “we the corporation must provide competent management whose actions must be just and fair.” The third area focuses on taking good care of the communities and the last paragraph says “when we are operating according to these principles, the shareholders should realise a fair return.”

That is the practical application of the things I talked about. We must ask ourselves, ‘are we doing that today?’ The answer is no, we are not. Why? Because business and free market capitalism were hijacked – and I use this term deliberately. As a consequence, business has become a major contributor to income inequality and shareholder primacy is eroding market value, it is a cancer eating the heart of society and the heart of the corporation itself. I say that because, in reality, shareholder primacy means that 90 cents out of every dollar of profit goes to the shareholder.

Figure 3 shows the innards of our system today. Amazingly profits are at an all-time high, despite the fact that there is a depressed worldwide economy. How did we get here? Productivity and wages rose together from the end of the Second World War to the end of the 1970s. From 1980 onwards wages flat-lined. This is a 40-year problem, wages can barely keep up with inflation. This is one of the reasons that profits have gone up so much. As a result, the share of labour as a percentage of GDP is down, investment in business is down. This is shareholder primacy; they do not invest a lot in R&D because they are getting 90 cents out of every dollar.

What about basic research? The market share went from almost 80% down to 6% in 2007. That foretells future creativity and innovation. In terms of competitive R&D investment we see that we are in a pretty sad competitive position. This is not an issue for all businesses, it is an issue for public corporations; private companies, however, tend to do better.

How does all this happen? It is financial engineering. Stock buybacks is the major solution, as we were saying money is almost free, so you use free money to buy back stock. Stock buybacks and excessive cash dividends are currently the highest in history.
Businesses today are also hoarding cash, at least $1 trillion every year, which is not subject to taxation in most markets. So we have money to pay people more and invest in corporations for their future but we do not. Because the market says that you have to return to shareholders more total shareholder return, every quarter, which means the price earnings ratio has to go up. Therefore keeping cash is ok – because all they care about is the price earnings ratios. This began to happen in the late 1970s when the wealthy took control of their own destinies and bought their way to all kinds of entitlements. We have a tax code that is full of entitlements for the rich that is extraordinary. People do not pay taxes, as we know from the last presidential election when presidential candidates did not want to reveal how much they pay because it was under 10%. There are some corporations in America, including General Electric, that pay zero taxes in America.

Milton Friedman in 1980 said that the role of business is to increase shareholder value and that morphed into what is today’s mantra, today’s market definition of the rules of the game: to maximise short-term shareholder value – with the emphasis on those two terrible words, maximise and short-term. That is the problem and that is the definition of why shareholder primacy does not work, but like it or not, that is where we are.

The justification today is very simple. Shareholders are corporation owners and they are entitled to maximum returns at any time. Those very aggressive shareholders who care for every penny that is being spent, except when it comes to paying CEOs because they are needed to deliver the short-term results. During those marvellous years, the golden era, the ratio of CEOs wages to employees was 20:1 and today it is, on average, more than 700:1. Their tenure of CEOs is also very low, under 4 years. So no wonder we get this constant short-term mentality because the new CEO coming in says ‘I know what happened to my predecessor, he didn’t deliver short-term so he’s gone.’

So the question should arise, is the shareholder an owner? They come into an equity when they want, they leave when they want. Do owners behave that way? The shareholders are also immune to all corporate liabilities and problems. They are not owners. There is no legislation ever that says that the shareholder is an owner. That is a total myth.

My next point is on the shareholder activist, they work with management and give them ideas. They can even take over the company with the idea to hold because there is value to be unleashed. They hang in there to take advantage of that. Warren Buffet says ‘our favourite holding period is forever’. They buy a good company and expect management to keep on
investing in the business and to keep it going into perpetuity and that can be done. Then we have a new negative group, I call them ‘the terrorist activists’. That is what they are, they blackmail, they ‘strip and flip’. They come in and fire a lot of people, they take out the profits and then they leave, they do not hold. They create a climate of fear. I talk to some of my colleagues who run businesses today and they say ‘I get killed if I try to do something different’.

But there is value here, because if we truly understand the problem in depth, the solution begins to write itself. I believe in the free market engine of drive. The free market and the profit motive can be very healthy. But we have to change our behaviour and the culture of shareholder primacy – that is a disaster. It is very critical to understand in the 21st Century, that the value creators are not the CEOs. The value creators are in fact the employees. Capital today is cheap, but what drives the future of business is innovation and creativity, and so corporations have to invest in the value creators and pay them a fair amount of money. That’s part of the problem, we have no middle class, because the middle class is not being paid, as you saw the wages have flattened out. It is not just a question of generosity it is a question of fairness.

I believe in a higher minimum wage, a living wage. But I do not believe in a single number, because a single number is wrong somewhere. We must invest in training and retraining. Hundreds of thousands of jobs go unfilled in America today because people do not have the skills to fulfil the needs that are already there. Corporations must invest in innovation and give brands sustained differentiation and relevance both in perception and in the product itself. Right now brands are being milked because they all want short-term results. The CEOs must be evaluated and paid more than just with shares; they must have sustained profitability and focus on margins and balance the five stakeholders.
You may think that I am a 1990s shareholder guy, but I am not. I like for shares to return capital and see them grow. A friend of mine, Jagdish Sheth at the Emory University of Atlanta, took 40 companies and termed them Firms of Endearment in his book of the same name. He says these are companies that do all the right things. He looked at them over a 15-year period of time and what he found was amazing. These firms of endearment did very well in the real market. So here is the irony, the ridiculousness of shareholder primacy, it does not work very well. Even in the short term of a 5-year return, the firms of endearment do better. The shareholder primacy strategy is ruinous and at the same time it does not work.

To change things in the longer-term and create new jobs, we must worry about education, both in terms of secondary and higher education. We must also provide early education for children and also be humble and have the humility to say that the trade school system works.

Before I conclude, I would like to talk about one more issue: partnerships between the government and industry. In the healthcare industry for example, governments invested colossal amounts of money to decode the human DNA. Once it was decoded, private industry came in and monetised those innovations. As a result, today we have probably millions of jobs around the world due to those huge investments which were originally made by governments.

The point is we need to evolve to a fairer, more just, more relevant, free market capitalism. I am a capitalist, I want to win the right way. I want to avoid having to be taxed to death to solve the problem because that is not a wise long-term thing to do. I do not want to have pitchforks in the streets to tell us what to do.

So the overall summary is obvious, we have to get away from income inequality and the loss of opportunity must be eliminated. We have to give people jobs, people need rewards, self-esteem and the dignity of having jobs. I disagree with people like Robert Gordon, who says that these problems are insurmountable and the good days are behind us. That is not true, business can and should take the lead in the short-term and act; because business has the most to win and the most to lose if we do not do that. I say, pay higher wages, create more jobs, re-imagine education. And that will get us to equal opportunities for all Americans – which was the American dream. I know about this because I experienced it. I arrived at the US at 15 years of age with nothing.
We need a collaborative effort with the participation of CEOs, boards of directors, equity holders, pension funds, labour leaders and the media. Media must stop talking about all this negativity and focus on celebrating on all the good things people can do to create solutions. Let’s change this negative culture into a positive one.

There is an overall principle here, a sense that business can operate in the centre of the universe and disconnected from society; that society does not matter and the consequences of business do not matter. I say that principle has to change: business’s success and the community’s success are connected. The future can be terrific, we have all the resources and we know how to do it, but we have to have the will to act now.

Thank you.

QUESTION AND ANSWER SESSION:

Ambassador Yohannes: This was a very powerful presentation. The numbers should scare everyone. Peter is a great leader and advocate against income inequality. This is a concern for President Obama, and we see it manifest in our political processes in the US today. Having said this, I also believe that business is a great partner and I too have spoken to business leaders and have gotten a lot of pushback. Some told me to go away because I was trying to create class warfare, and others did not understand that they should act.

Peter the current situation is not sustainable, so how can we get the majority of businesses to accept and understand that this is in everyone’s interest. What needs to happen?
Secretary-General: All this money is sitting there and it is not being used for investments. It is used for buy-backs and mergers. Clearly there must be policy issues there that have to do with taxes and governments’ approach to the business world.

Q1. I very much like the bottom-up approach you mentioned and making the business case for the need to tackle inequality. How can we engineer the change and move away from the short-term maximisation syndrome? And how can the OECD help in this area? We can present the evidence and stress capitalism is at risk if we do not tackle this problem. What more can we do?

Q2. Do you worry about the cult of the CEO in the economy and to what degree may we begin to change who the spokespersons of capitalism are?

Q3. I wanted to mention the OECD’s Corporate Governance Principles. We very much buy into your mantra of stakeholder value and maximising returns of all stakeholders. What could trigger the change that you speak of given that the rhetoric is there?

Peter Georgescu: I want to explain the fact that this avalanche of awareness of income inequality is only about 18 months old. When I started working on this book, there was nothing in the US media about this problem. A drumbeat is now building. There is an education process that has to take place. The presentation I made today was not made for you, it was made for my colleagues, my CEO friends. Some of us get it, and some of us ask for help. I think we can collaborate and we need to organise these voices together. This is not a liberalist conservative issue. This is us capitalists saying, ‘we all need to save this system’.
Change is going to be hard and it is going to be a long struggle. Changing persuasions is hard and changing behaviour is harder – but that is how we have to do it. We must first change the understanding of this situation and then eventually we must change behaviour. There is no silver bullet.

I think we all have to play different roles. The Secretary-General is right, we must get the governments to play and monetary policy is critical. Fiscal policy in the US today is outrageous. In the US, you have the White House which has been trying heroically to accomplish a great deal to help people; the Affordable Care Act is one example. But on the other hand, Congress has been deadlocked and has not been able to act on other areas such as fiscal policy.

I’m glad the issue of media came up. Media must inform, we have to create a deep awareness and elect the right people to go to Washington and to Paris and to all the capitals of developed nations and rally this message. We have a responsibility to work at policy level and to communicate the understanding of the problem deeply into the media and the population so people can elect the right government officials.

On the question of who are leading corporations today, too many of them are financial engineers or lawyers. It is not business builders or marketing types. It is the technocrats who bought into the system and perpetuate the system. The next generation of leaders will be a different kind, those who understand the responsibility to all those 5 stakeholders that I mentioned.

I am saying this is a struggle, this is a journey and the good news is we can have a very happy ending.

Thank you very much.

All Photos: OECD/Marco Illuminati
The Coffees of the Secretary-General
is delighted to present

Peter Georgescu

“Capitalists Arise: defining the problems
and consequences of inequality”

3rd May,
11h45-13h00,
CC13